

# MANUAL TRANSMITTAL

Department  
of the  
Treasury

Internal  
Revenue  
Service

7.6.2 CH. 5

JULY 8, 1999

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## PURPOSE

This transmits new table of contents and text for IRM 7.6.2, Exempt Organizations Examination Procedures, Chapter 5, Examination Guidelines for Municipal Financing Arrangements.

## NATURE OF CHANGES

IRM text pertaining to IRM 7.6.2, Exempt Organizations Examination Procedures; Chapter 5, Examination Guidelines for Municipal Financing Arrangements provides guidelines for the examination of municipal financing arrangements.

Proposed guidelines issued in Announcement 95-61 are in the new IRM format and revised.

New procedures for rebate and small issue bonds are incorporated. Closing procedures are revised to include appeals and closing agreement procedures are updated.

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Director,  
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## 7.6.2 Exempt Organizations Examination Procedures

### Chapter 5 Examination Guidelines for

### Municipal Financing Arrangements

page 1

5.1 (07-08-1999)

#### **Overview**

- (1) This section provides procedures for examining financing arrangements of states and their political subdivisions for compliance with the Code and regulations under the Tax Exempt Bond Program.
- (2) These guidelines apply to all arrangements purporting to involve debt obligations of states and their political subdivisions whether styled as notes, bonds, installment sales, lease financing arrangements, or otherwise.

5.1.1 (07-08-1999)

#### **Goals**

- (1) The Tax-exempt Bond Program will combine compliance initiatives with enforcement measures to accomplish the following goals:
  - a. Achieve significant levels of audit coverage;
  - b. Respond promptly to abusive transactions;
  - c. Increase the effective use of information returns;
  - d. Encourage issuers to take an active role in ensuring that their bond issues comply with the Code and regulations; and
  - e. Otherwise promote voluntary compliance with the requirements of the Code and Regulations.

5.1.2 (07-08-1999)

#### **Terminology**

- (1) The state or political subdivision or entity that issues bonds on behalf of a state or local government is referred to as the “**Issuer**”.
- (2) The financing arrangement is referred to as the “**municipal financing arrangement**”.
- (3) Each owner of an obligation is referred to as a “**bondholder**”.
- (4) A borrower of proceeds from the financing (other than a borrower of proceeds of mortgage revenue bonds or student loan bonds) is referred to as a “**conduit borrower**”.
- (5) An entity which is listed as the registered owner but who is not the beneficial owner of the bonds is referred to as the “**nominee.**”
- (6) The collection of bound legal documents relating to a municipal financing transaction is referred to as a “**bond transcript**” or “**closing book.**”

5.2 (07-08-1999)

#### **Responsibilities**

- (1) This section summarizes the responsibilities of the various offices involved in the tax-exempt bond examination program.

5.2.1 (07-08-1999)

**Headquarters**

- (1) The Assistant Commissioner (Employee Plans/Exempt Organizations):
  - a. Is responsible for program enforcement
  - b. Sets the policies, objectives and procedures of the Program
  - c. Compiles and disseminates information to the Regions and Key Districts
  - d. Institutes compliance initiatives, such as information gathering projects
  - e. Coordinates the activities of the Regions and the Key Districts
  - f. Carries out quality control procedures
  - g. Coordinates with other functional areas and government agencies
- (2) The Associate Chief Counsel (Domestic):
  - a. Provides legal support to the regions, the Key Districts, the AC(EP/EO) and District Counsel
  - b. Carries out all activities relating to matters in litigation
  - c. Publishes regulations, revenue rulings, revenue procedures, notices and announcements
  - d. Issues private letter rulings and technical advice memoranda

5.2.2 (07-08-1999)

**Regional Office**

- (1) The regional office is responsible for complying with Program procedures and monitoring the Program to ensure that each Key District fulfills its responsibilities as specified in the Business Master Plan and the EP/EO Workplan.

5.2.3 (07-08-1999)

**Key District**

- (1) Key District Directors who implement the Program within their respective districts,
  - a. Negotiate closing agreements with issuers
  - b. Provide quality review of examination cases
  - c. Participate in special initiatives such as sampling and nationwide information gathering projects
  - d. Coordinate with other government agencies.

5.2.4 (07-08-1999)

**District Counsel**

- (1) District Counsel provides the following support for the tax-exempt bond examination program:
  - a. Substantive legal analysis to the Key Districts;
  - b. Case-specific advice to the AC(EP/EO), the Regions, the Key Districts and to Appeals;
  - c. Development of the facts necessary to support the legal analysis;
  - d. Assists Key Districts in complying with procedures such as preparing requests for John Doe summonses;
  - e. Assists the Key Districts in determining whether to request technical advice and enter into closing agreements.

## 5.2.5 (07-08-1999) **Appeals**

- (1) The Appeals function provides an administrative appeal of an adverse determination by a Key District that interest on a bond issue is not excludable from gross income under §103 of the Internal Revenue Code.
  - (2) Appeals also coordinates settlements with issuers and bondholders on cases under their jurisdiction.
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## 5.3 (07-08-1999) **Selection of Cases**

- (1) Cases selected for examination originate from the following sources:
    - a. Referrals from Headquarters, other federal agencies, informants or news articles;
    - b. Information gathering projects and compliance initiatives;
    - c. Classification of returns filed by issuers or by conduit borrowers.
- 

## 5.4 (07-08-1999) **Conducting the Examination**

- (1) Case development is accomplished at the issuer level. Bondholders are generally not contacted until the Service has completed an examination of the bond issue and determined that the issue fails to comply with the Code and regulations.
- (2) Treat issuers as taxpayers with respect to the bond issue for the following purposes:
  - disclosure;
  - technical advice requests;
  - third party contacts;
  - appeals; and other purposes.
- (3) The period of limitations for assessing the tax against a bondholder is only suspended if the bondholder signs an extension of the period of limitations on its return.

## 5.4.1 (07-08-1999) **Pre Examination Research**

- (1) The examiner should consider reviewing the following documents as part of the pre-examination research:
  - Issuer information returns;
  - Filings with the nationally recognized municipal securities information repository ("NRMSIR") and the state information depository ("SID").
  - Forms G-36(OS) and G-36(ARD) filed with the Municipal Securities Rulemaking Board Municipal Securities Information Library.
  - Other pertinent state or federal agency reports or files.
- (2) The examiner should contact the District Counsel Bond Liaison when questions arise or when the bond interest may be taxable.

5.5 (07-08-1999)  
**General Examination Procedures**

- (1) The examiner will inform the issuer of the examination at the beginning of an examination. For examinations arising from an information gathering program, a Compliance 2000 project, or any other project based on statistical sampling, the project guidelines will include specific instructions concerning the initial contact letter. For all other examinations, follow the format of Exhibit 5.1-1. The letter to the issuer may incorporate the agent's initial request for information.

5.5.1 (07-08-1999)  
**Examination Steps**

- (1) This section provides specific steps to follow when conducting the tax-exempt bond examination.
  - a. Inform the issuer of the specific tax-exempt bond issue under examination.
  - b. Obtain and review the bond transcript. If the issuer does not have the bond transcript, contact any party to the transaction to obtain a copy.
  - c. Determine whether the bonds are governmental or qualified private activity bonds.
  - d. Develop legal and factual questions. Third party investigative inquiry may be necessary. See Disclosure of Information Handbook, IRM 1272 (21). Any summons that is necessary to obtain information on the bond issue should be issued with respect to the Form 8038 for the issuance. If the summons is a third party summons, send notice to the issuer. If information is sought from a bank, consult District Counsel.

**If the Agent with Key District review concludes that a:**

**Then:**

Favorable Ruling is Appropriate	Close Case. Follow the format of Exhibit 5.1-2.
Preliminary Adverse Determination is Appropriate	Consult with District Counsel to determine whether Technical Advice should be requested;  If Technical Advice is not requested, notify issuer of preliminary adverse determination and provide opportunity for a closing agreement.  If no closing agreement, issue adverse determination and notify Issuer of availability of administrative appeal.

**If the Agent with Key District review concludes that a:**

**Then:**

<p>Technical Advice Requested</p>	<p>Submit Technical Advice request to Branch 5 of the Office of Assistant Chief Counsel (Financial Institutions &amp; Products) (CC:DOM:FI&amp;P)</p> <p>When Chief Counsel issues the Technical Advice Memorandum, notify issuer in writing of determination.</p> <p>Written notice will identify the Bond Issue under examination, include a copy of the technical advice memorandum, and if adverse to issuer, inform issuer of availability of administrative appeal.</p>
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5.5.2 (07-08-1999)  
**Taxing Interest Income**

- (1) When an adverse Technical Advice Memorandum has been mailed and no appeal requested, begin the process of taxing bondholders. Generally, if a municipal financing arrangement does not comply with the Code and regulations, interest income is includable in the bondholders' gross income from the issue date of the bonds. The period of limitations will limit the ability to collect tax.
- (2) To collect tax from taxpayers

<p>If returns have been filed</p>	<p>Send bondholders statutory notices of deficiency</p>
<p>If returns have not been filed and the bonds are still outstanding</p>	<p>Instruct the issuer to notify the nominee paying interest to the beneficial owners of the bonds to send Forms 1099-INT to those bondholders. If the nominee is known, also notify the nominee directly.</p>

- (3) The examiner will contact District Counsel if any conduct involving the bond may warrant a penalty.

5.5.3 (07-08-1999)  
**Arbitrage Examination**

- (1) This section provides guidance when an examiner encounters an arbitrage issue in an examination.
- (2) Under IRC 103, the interest on an arbitrage bond is included in gross income. A bond is an arbitrage bond if it does not meet the yield restriction requirements of IRC 148(a) or the rebate requirements of IRC 148 (f). IRC 148(a) provides that, with certain exceptions, each bond in an issue of bonds is an arbitrage bond if the yield on invested proceeds of the issue is reasonably expected on the issue date to be materially

higher than the yield on the issue, or if the issuer intentionally uses those proceeds to earn a materially higher yield. Under IRC 148 (f) , even if the issue is within an exception to yield restriction, an issuer may be required to rebate to the United States any arbitrage earned on nonpurpose investments allocated to gross proceeds of the issue. If the issuer fails to pay the required rebate, the bonds are arbitrage bonds.

5.5.3.1 (07-08-1999)  
**Procedure**

- (1) Determine which regulations apply under IRC 148.
- (2) Check the accuracy of the Issuer's calculation of yield on the issue by determining the following:
  - a. Whether the bonds are outstanding;
  - b. The issue date and purchase price of the bonds;
  - c. Payment schedule for the bonds;
  - d. Redemption price at maturity;
  - e. Final maturity date;
  - f. Whether the bond is subject to early redemption;
  - g. Whether there is a credit enhancement that is a qualified guarantee;
  - h. The existence of hedges;
  - i. Whether the issuer has transferred, modified, or similarly waived any right attached to the bond;
  - j. Whether issuer has used consistent accounting conventions;
  - k. Check for accuracy of present value computations.
- (3) Determine whether yield restriction rules are violated by examining the yield on each individual investment within each class of investments.

5.5.3.2 (07-08-1999)  
**Computing Rebate**

- (1) Compute rebate under the future value method by obtaining the following:
  - a. Identify nonpurpose investments (defined under Reg. 1.148-1(b) allocated to the issue;
  - b. Construct a schedule showing the amounts and dates of payments and receipts with respect to the nonpurpose investments. Show payments as negative amounts, receipts as positive amounts. Create another column showing the future value of each payment and receipt as of the rebate computation date. The sum of the future value amounts is the rebate amount.
  - c. Obtain copies of the issuer's Form 8038-T.
  - d. Examine the issuer's books and records to locate any elections made by the issuer.
  - e. Determine whether rebate computation dates should be accelerated. Contact District Counsel before sending a notice of demand for payment.

5.5.3.3 (07-08-1999)

### **Issuers Ability to Remedy Failures to Satisfy the Arbitrage Requirements**

- (1) Under Reg. 1.148–5(c), the issuer may sometimes reduce the yield on nonpurpose investments by making payments to the United States. In addition, under IRC 148(f)(7) and Reg. 1.148–3(h), an issuer may sometimes remedy a failure to make a timely rebate payment. These provisions apply only to certain failures to satisfy the arbitrage requirement. They do not cure other failures to satisfy other requirements of IRC 103 and IRC 141 through 150.

5.5.4 (07-08-1999)

### **Special Examination Procedures for Secondary Market Transactions**

- (1) Bonds are sometimes “repackaged” or guaranteed by underwriters or other bondholders for resale on the secondary market. The issuer may have no involvement in these cases since the excludability of the interest received by the bondholders may depend on the terms of the secondary market arrangement or guarantee. Contact District Counsel for guidance.

5.5.5 (07-08-1999)

### **Special Procedures for Examinations of Conduit Borrowers**

- (1) The examiner should start an issuer level examination if an examination of a nongovernmental conduit borrower indicates that a bond may not comply with the Code and regulations.
- (2) Check the Integrated Data Retrieval System (“IDRS”) to determine if the return of the conduit borrower is under examination or in unstarted inventory. Coordinate with Examination if a return is charged out to an Examination group.
- (3) Interest on qualified 501(c)(3) bonds may be includable in bondholders’ gross income if the 501(c)(3) conduit borrower either has its exempt status revoked or uses bond proceeds in an unrelated trade or business. If either of these events has occurred, an issuer level examination should be started. If a Technical Advice Memorandum on issues concerning the exempt status of the conduit borrower or unrelated business income tax is needed, it must be requested from Headquarters, Exempt Organizations Division (OP:E:EO).

5.5.6 (07-08-1999)

### **Pooled Bonds**

- (1) Bond issues of which the proceeds are loaned to two or more ultimate borrowers are called pooled financing bonds. In cases of pooled financing bonds where loans are made to borrowing governmental units, the loans can be tax-exempt bonds. In these cases the issuer of the pooled financing bonds should generally be treated as the issuer and the borrowing governmental units should generally be treated as conduit borrowers. See IRC 149(f) and 149(g) for the special rules which apply to pooled financing bonds.

**5.5.7 (07-08-1999)  
Qualified Small  
Issue Bonds**

- (1) This section provides procedures for examining qualified small issue bonds under IRC 144(a) of the Internal Revenue Code.
  - a. Determine if the issuer is a qualified issuer.
  - b. Determine if the issue is refunding or new money.

**5.5.7.1 (07-08-1999)  
New Money**

- (1) Determine the facilities financed with the small issue.
- (2) Determine if the facilities are qualified facilities to be financed with a small issue tax-exempt bond.
- (3) Determine whether 95% of the proceeds of the issue were used for the project or for refunding.
- (4) Determine the principle user(s) of the facility.
- (5) Identify any related parties of the principal user(s).
- (6) Identify any other bond financed facilities of the principal user(s) or related parties in the same incorporated municipality or same county.
- (7) Determine whether the type of bond used to finance the other facilities was a small issue bond, an exempt facility bond, a redevelopment bond or an IDB issued under the 1954 Code to which IRC 141(a) does not apply.

**5.5.7.2 (07-08-1999)  
Size Limitations**

- (1) The following procedures should be taken into account when determining if size limitations have been exceeded.

**5.5.7.2.1 (07-08-1999)  
\$1,000,000  
Limitation**

- (1) Determine the aggregate of the face amount of the issue under examination and the face amount of outstanding prior small issues used to finance facilities located within the same incorporated municipality or county, and which have the same principal users (or a related party) as the facility financed with the issue under examination.

**5.5.7.2.2 (07-08-1999)  
\$10,000,000  
Limitation**

- (1) Determine if a proper election was made to substitute \$10,000,000 for the \$1,000,000 limitation. See 1.103-10(b)(2)(vi) of the regulations.
- (2) Determine whether the aggregate face amount of the small issue exceeds \$10,000,000 by adding to the amount determined under 5.5.7.2.1 above, the aggregate amount of capital expenditures with respect to the facilities located within the same incorporated municipality or county that were paid or incurred during the 6-year period beginning 3 years before the date of the issue and ending 3 years thereafter.
- (3) Determine whether any of the capital expenditures on any facility financed with the net proceeds of a small issue also benefited from an

urban development grant (UDAG). If so, ignore up to \$10,000,000 of capital expenditures for purposes of this limitation.

5.5.7.2.3 (07-08-1999)  
**\$40,000,000  
Limitation**

- (1) Determine the test period beneficiaries of the small issue financed facility during the 3-year period beginning the later of when the facilities were placed in service or when the bonds were issued.
- (2) Determine whether the test period beneficiaries were owners or users of other facilities in any state financed with "tax-exempt facility related bonds" (exempt facility bonds, small issue bonds, redevelopment bonds under IRC 142 and 145 and IDBs issued under the 1954 Code to which IRC 141(a) does not apply).
- (3) Determine whether any of the tax-exempt facility related bonds were outstanding at the time of the issuance of the small issue.
- (4) Determine the aggregate face amount of the outstanding tax-exempt facility related bonds allocated to a test period beneficiary by finding the proportionate amount of the outstanding tax-exempt facility related bonds allocated to each test period beneficiary.
- (5) Determine whether the aggregate face amount of the small issue plus the aggregate face amount of the facility-related bonds allocated to a test period beneficiary exceeds \$40,000,000.

5.5.7.3 (07-08-1999)  
**Refundings**

- (1) Determine if net proceeds were used to redeem part or all of a prior issue which was used for the acquisition, construction, reconstruction of land or depreciable property.
- (2) Determine whether the net proceeds of refunding bonds were used to redeem refunded bonds not later than 90 days after the date of issuance.
- (3) Determine if the average maturity date of the refunding bond is no later than the average maturity date of the refunded bond?
- (4) Determine if the amount of the refunding bond is greater than the outstanding amount of refunded bonds?

5.5.7.4 (07-08-1999)  
**Maturity**

- (1) Determine if the average maturity of the bonds exceeds 120% of the average reasonably expected economic life of the facilities being financed with the net proceeds IRC (147)(b).

5.5.7.5 (07-08-1999)  
**Discrepancy  
Adjustments**

- (1) Determine the depreciation method used for assets purchased with tax-exempt bond proceeds.

**5.5.8 (07-08-1999)  
Procedures for  
Obtaining the  
Names of  
Bondholders**

- (1) Interest and principal payments on the bonds generally do not go directly from the source of the debt service payments to the bondholders. If there is a trustee for the issue, it is likely that the trustee receives payments from the paying source and distributes the debt service payments. The trustee may be making the payments to a nominee. There may be several tiers of nominees between the paying agent and the owner of the bond.
- (2) As soon as a preliminary adverse determination is made, the agent should consider requesting bondholders' names from the issuer.
- (3) If the issuer does not timely provide the bondholders' names, the agent should seek the names from the trustee or the respective nominees. If the agent has a reasonable basis to believe that the trustee cannot provide the names, the first summons may be issued to the first tier nominee. District Counsel should be consulted.
- (4) The agent may also be able to obtain a continuing John Doe summons to eliminate the need for repetitive court approval. A dual purpose summons may be available if the person to whom the summons is being issued is also a possible beneficial owner of the bonds.

**5.5.9 (07-08-1999)  
Other Remedies**

- (1) In addition to collecting the income tax owed by bondholders the agent should also consider other actions that may be taken.
  - a. First, certain participants to the municipal financing arrangement may be subject to IRC 6700. See IRM 120.1.6 (Preparer/Promoter/Protestor Penalties).
  - b. Second, under IRC 150(b) certain users of facilities financed with qualified private activity bonds may be denied deductions, or may be attributed with unrelated trade or business income, if they fail to use the facilities for qualified purposes.

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**5.6 (07-08-1999)  
Closing  
Agreement  
Procedures**

- (1) This section sets forth procedures for entering into closing agreements with issuers with respect to their bonds which do not comply with the Code and regulations. These procedures seek to ensure consistency among districts, issuers and taxpayers.
- (2) Although issuers are not liable for tax when a municipal financing arrangement fails to comply with IRC 103, an issuer may be willing to enter into a closing agreement so that its bondholders are not taxed on the interest they receive. Closing agreements must be signed by the issuer. Other parties to the financing arrangement, such as the conduit borrower, may wish to participate in the negotiations. The issuer must complete a Form 8821 to allow participation by others.

5.6.1 (07-08-1999)  
**Coordination**

- (1) If the Service is going to initiate the closing agreement discussion, a preliminary adverse determination that interest on the Bond is not excludable from gross income should be sent to the issuer and the procedures in section 5.8.1 should be followed.
- (2) Prior to entering into a closing agreement with an Issuer, key district offices will forward a summary of the proposal to Headquarters for review. The summary should include a description of the issue(s) with related legal analysis, proposed terms of the agreement and the basis on which the proposed settlement amount was reached. The information submitted must also include an explanation regarding the involvement of district counsel in developing the proposal.
- (3) The District will negotiate the terms of the closing agreement in coordination with District Counsel.
- (4) Once the agreement has been executed by the Issuer, it is forwarded to the District Director for signature. See Exhibit 5.1–3 for model closing agreement language.
- (5) A copy of the executed closing agreement is forwarded to Headquarters and a copy is also forwarded to the Ogden Service Center.

If...

Then...

a municipal financing arrangement is under examination by a KDO	The KDO is responsible for negotiating and signing the closing agreement
the municipal financing arrangement is not under examination and the issuer seeks to enter into a closing agreement such as under the provisions of Rev. Proc. 97–15	The AC (EP/EO) is responsible for negotiating and signing the closing agreement with the Key District's concurrence.

5.6.2 (07-08-1999)  
**Terms of Closing Agreement**

- (1) Payment of any closing agreement amount should be made before or at the time the agreement is executed by the Service.

5.6.3 (07-08-1999)  
**Disclosure Provision**

- (1) The terms or existence of a closing agreement is return information protected by IRC 6103. A separate disclosure consent to disclose certain aspects of the agreement may be obtained and signed simultaneously with the closing agreement to allow the Service to discuss the agreement. See Exhibit 5.1–4.

5.6.4 (07-08-1999)  
**Bond  
 Redemption**

- (1) In general, the purpose of IRC 141 through 150 is to limit the volume of tax-exempt bonds on the market. When negotiating a closing agreement, consider whether bonds can be redeemed early.

5.6.5 (07-08-1999)  
**Basis for  
 Closing  
 Agreement  
 Amount**

- (1) Closing agreements should be based on one of the following:
- a. Total taxpayer exposure — Generally, the closing agreement amount should be based on the total taxpayer exposure which is the amount of tax the Service could collect if bondholders paid tax on the interest they have earned and will earn on the bonds. Taxpayer exposure for any year is equal to (i) the interest both accrued and scheduled to accrue in that year on the outstanding bonds multiplied by the relevant tax percentage plus (ii) interest at the underpayment rate on that amount. The “relevant percentage” is based on the Service’s estimate of the average investor’s highest tax bracket.
 

The total taxpayer exposure for prior years is calculated by adding together the taxpayer exposure for all open years. Taxpayer exposure for future years should be computed on a present value basis, using the taxable applicable federal rate (semiannual compounding) as the discount rate.
  - b. Arbitrage profits — It may be appropriate to calculate the closing agreement amount based on the amount of arbitrage profits rebatable to the United States under IRC 148(f) when the issuer failed to rebate such profits. If neither taxpayer exposure nor arbitrage profits seems to be an appropriate basis for a closing agreement, consult with District Counsel about other alternatives.

5.6.6 (07-08-1999)  
**Closing  
 Agreement  
 Amount**

- (1) After determining the appropriate basis for the closing agreement amount, several factors can be applied to that basis to calculate what percentage of that amount the Service should accept in a closing agreement. The relevant factors may include, but are not limited to: the collectability of the total taxpayer exposure; hazards of litigation; whether the issuer voluntarily brought the problem to the Service’s attention; whether the violation was inadvertent; and whether the abuse was severe.

5.7 (07-08-1999)  
**Procedures  
 under IRC  
 148(f)(7)**

- (1) Many failures to comply with the requirements of IRC 103 cannot be retroactively corrected. However, there is one failure that can be retroactively corrected.
- a. If an issuer fails for reasons other than willful neglect to make a timely payment of the full amount of arbitrage rebate due, and pays the amount described in IRC 148(f)(7), then the issuer will be treated as if it had made a full, timely payment.
  - b. If other bases exist besides the failure to make a timely rebate payment, and if taxpayer exposure exceeds the amount of rebate

due, than an amount greater than the amount described in IRC 148(f)(7) may be required to enter into a closing agreement.

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5.8 (07-08-1999)  
**Processing  
Refund Claims**

- (1) Refund claims should be processed to determine the accuracy and validity of the request for refund. It is not intended that each request for refund of rebate trigger the commencement of an audit of the underlying bond issue. To do so would impair the issuer's decision to seek a refund of rebate that is overpaid.
  - (2) The information required by Revenue Procedure 92-83, 1992-2 C.B. 487, should be solicited in every case, as well as any additional information necessary to process the claim for refund.
  - (3) If the information submitted suggests the underlying bonds may not be tax exempt, an audit of the bond issue may be required. The decision to initiate an examination should be agreed to by the group manager before the issuer is contacted.
  - (4) If a refund request is deficient, contact the bond issuer or the issuer's representative for further information.
  - (5) Forward approved refund requests to the Ogden Service Center for payment.
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5.9 (07-08-1999)  
**Administrative  
Procedures**

- (1) The following outlines the various reporting requirements for the tax-exempt bond examination program.
- (2) Each Key District will complete a quarterly report on the Tax-exempt Bond Program examinations containing the following information:
  - a. the name of the bond issue, report number and issuer;
  - b. issuer EIN;
  - c. the stated redemption price at maturity of the bond;
  - d. a brief explanation of the issues being developed; and
  - e. the status of the case (include contacts with Headquarters and District Counsel) and the results if the case is closed.
- (3) Reports will be submitted to the Director, Exempt Organizations Division, by each January 31, April 30, July 31 and October 31.

5.9.1 (07-08-1999)  
**Time Reporting**

- (1) Charge time spent on Tax-Exempt Bond Program examinations and other compliance initiatives to activity code 397100.
- (2) The following project codes will be used to identify the specific type of Tax-exempt Bond Program activity:

- 017—Non-EO Forms 8038 examinations (includes Forms 8038, 8038–G, 8038–GC, 8038–T and 8328)
- 018—Non-EO bond compliance activity;
- 050—EO bond compliance activity;
- 053—Bond compliance initiative
- 056—Tax-Exempt Bond related returns
- 076—EO Forms 8038 examinations
- 103—Tax-Exempt Bond Focus Group
- 105—Timely use of bond proceeds
- 110—Small issue compliance follow-up

- (3) If a Coordinated Exam Program (“CEP”) time is involved, time spent on Tax-exempt Bond Program activities will be reported in the narrative section of the CEMIS reports. When Tax-exempt Bond Program activities expand to a formal examination of a bond issue, project code 091, CEP related entity return, and activity code 397100 should be used.

5.9.2 (07-08-1999)

**Case Controls**

- (1) Establish Tax-Exempt Bond examinations on AIMS using the Non Master File (“NMF”) procedures.
- (2) Use MFT 46 for tax-exempt bond examinations.
- (3) Use the project codes set forth in section 5.9.1(2).
- (4) Send approved arbitrage refund claims to the Ogden Service Center for payment.

**Exhibit 7.6.2.5-1 (07-08-1999)****Sample Contact Letter**

Issuer  
Street Address  
City, State, ZIP Code

Person to Contact  
ID#  
Contact Telephone Number  
Date

EIN

Re: [Insert name of bond issue(s) from line 7 of Form 8038 and/or CUSIP Number(s) and/or Report Number(s)]

Dear Sir or Madam:

In Announcement 93-92, The Internal Revenue Service announced that it would initiate an expanded compliance program for tax-exempt bonds. We have selected the bond issue(s) named above for examination. The examination relates only to the identified municipal financing arrangement(s). No other municipal financing arrangements or the general operations of the issuer are within the scope of the examination.

We have scheduled the examination to begin at [insert time] on [insert date] at your office. If the date, time, or location is inconvenient for you, please call the person whose name and telephone number appear above to schedule a different time or place. Please have the complete bond transcript [for each of the municipal financing arrangements] available at the beginning of the examination. Other items may be requested as the examination proceeds.

If the examination is to be conducted with your representative, a power of attorney must be filed with the Service before your representative can receive or inspect confidential information. A Form 2848, Power of Attorney and Declaration of Representative, or any other properly written power of attorney or authorization may be used for this purpose. Copies of Form 2848 may be obtained from me or from any Internal Revenue Service Office.

Thank you for your cooperation in this matter. Please feel free to call me at the telephone number listed above.

Sincerely,

**Exhibit 7.6.2.5-2 (07-08-1999)  
Sample No Change Letter**

Issuer  
Street Address  
City, State, ZIP Code

Person to Contact  
ID#  
Contact Telephone Number  
Date

EIN

Re: [Insert name of bond issue(s) from line 7 of Form 8038 and/or CUSIP Number(s) and/or Report Number(s)]

Dear Sir or Madam:

We have recently completed our examination of the bond issue(s) named above. As a result, we have decided to close the examination with no change to the position that interest received by bondholders is excludable from gross income under section 103 of the Internal Revenue Code.

Please note that if the need to open another examination arises on this bond issue(s), any change resulting from that future examination may affect all open years of bondholders from the issue date of the bonds.

Thank you for your cooperation in this matter.

Sincerely yours,  
District Director

**Exhibit 7.6.2.5-3 (07-08-1999)**  
**Model closing Agreement Language**

**CLOSING AGREEMENT ON FINAL DETERMINATION  
COVERING SPECIFIC MATTERS**

Under section 7121 of the Internal Revenue Code (the "Code"), \_\_\_\_\_ (the "Issuer") and the Commissioner of the Internal Revenue (the "Commissioner" or "IRS") make this closing agreement (the "Agreement").

WHEREAS, the parties have determined the following facts and made the following legal conclusions and representations:

A. This Agreement is in settlement of issues raised in an examination of the \_\_\_\_\_ Bonds (the "Bonds").

B. The IRS has not formally asserted any claims against the Issuer, or sought to tax any holders of the Bonds on interest income of the Bonds.

C. The terms of the Agreement were arrived at by negotiation between the Issuer and the IRS and may differ from the terms of settlement of other bond issues examined or to be examined by the IRS.

D. This Agreement is for the benefit of the past, present and future registered and beneficial owners of the Bonds (collectively, the "Bondholders").

[Insert additional premises on which the Agreement is based including violations giving rise to interest on bonds being includible in gross income under section 61.]

NOW IT IS HEREBY DETERMINED AND AGREED PURSUANT TO THIS CLOSING AGREEMENT EXECUTED BY THE PARTIES HERETO UNDER CODE SECTION 7121 THAT FOR FEDERAL TAX PURPOSES:

1. The Issuer shall pay \_\_\_\_\_ to the IRS upon the Issuer's execution of this Agreement. Payments of this amount shall be made by certified check payable to the U.S. Treasury and delivered to a duly authorized representative of the IRS.

2. The Bondholders are not required to include in their gross income any interest on the Bonds because of the violations set forth herein.

3. No rebate payment under section 148(f) of the Code shall be due on the Bonds because of the violations set forth herein. [To be used if the Agreement includes settlement of an arbitrage rebate violation under section 148 (f)].

4. The Agreement does [does not] require that the Bonds be redeemed.

5. Notwithstanding anything to the contrary contained herein, the IRS may take appropriate action with respect to the Bonds, including taxing Bondholders on interest earned on the Bonds, for violations other than those set forth herein or for violations arising after the effective date of this Agreement.

6. This Agreement is executed with respect to a federal income tax liability of the Bondholders.

7. No income shall be recognized by any Bondholder as a result of this Agreement or any payments made pursuant to this Agreement.

8. No party shall endeavor by litigation or other means to attack the validity of the Agreement.

9. The amount paid by the Issuer pursuant to this agreement is not refundable, or subject to credit or offset under any circumstances.

10. This Agreement may not be cited or relied upon by any person or entity whatsoever as precedent in the disposition of any other case.



**Exhibit 7.6.2.5-4 (07-08-1999)**  
**Consent to Disclose Tax Information**

CONSENT TO DISCLOSE TAX INFORMATION

Subject to the conditions set forth in the succeeding paragraphs, we hereby authorize the Internal Revenue Service ("IRS") to make public any returns and return information (as those terms are defined in section 6103(b) of the Internal Revenue Code of 1986, as amended (the "Code")) of \_\_\_\_\_ (the "Issuer") relating to the Closing Agreement (the "Agreement") dated \_\_\_\_\_, between the Issuer and the Commissioner of the IRS, concerning \_\_\_\_\_ principal amount of \_\_\_\_\_ Bonds (the "Bonds") issued on \_\_\_\_\_.

The above described information may be disclosed by the IRS to members of Congress, the press, or the general public:

A. In the event of a default by the Issuer on any term in the Agreement; or

B. To the extent the IRS deems necessary to correct any material misstatements with respect to the Agreement in response to a public statement by the Issuer or an agent of the Issuer.

We are aware that without this authorization the returns and return information of the Issuer are confidential and are protected by law under the Code. We also understand that this consent does not constitute a general waiver of the rights of the Issuer to confidentiality under section 6103(a) of the Code. We understand that the IRS may disclose returns and return information (as described in section 6103(b)(1) and (2) of the Code) or the terms of the Agreement pursuant to this consent if, and only if, either of the circumstances in clause A or B occurs.

I hereby certify that I have the authority to execute this consent to disclose on behalf of the Issuer.

NAME OF ISSUER:

EMPLOYER ID. NO:

ISSUER'S ADDRESS

NAME OF INDIVIDUAL  
EXECUTING CONSENT:

TITLE:

SIGNATURE: \_\_\_\_\_

DATE: \_\_\_\_\_